

The Maryland Journal

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INTRODUCTION

THE LATE GEORGE STIGLER, a Nobel Laureate in economics, once remarked, “At most only a tiny set of policies have been studied with even moderate care.” Prof. Stigler’s conclusion holds true at the national, state, and local levels of government. Here in Maryland, the paucity of serious analysis of state and local government policy, while significant, is not unusual.

I have had some first-hand experience with policymaking and policy evaluation in Maryland. Allow me to reflect. When Marvin Mandel became Maryland’s 56th Governor in 1969, he acknowledged that the analysis of government programs was long overdue. To inform his governance, independent of state lobbyists and legislators, one of former Governor Mandel’s initial acts was to establish Maryland’s first (and last) Governor’s Council of Economic Advisors. The Council was mandated to conduct economic and financial analysis of government programs and policies and to advise the Governor in confidence.

I served as a Member of the Council, along with Prof. Clopper Almon of the University of Maryland and Prof. Carl Christ of The Johns Hopkins University. The Members served on a part-time, *pro bono* basis. We directed a full-time staff ably managed by Dr. Peter Karpoff. We had access to former Governor Mandel and met with him regularly.

Two things struck me about this experience. First, the Council’s work was conducted under very high quality standards. And second, the Governor paid the most careful and anxious attention to our products.

Shortly after former Governor Mandel left office, the Governor’s Council of Economic Advisors was forced, without a patron or funding, to close shop. Apparently, the new Acting Governor and the political class, as well as the lobbyists, didn’t have an appetite for careful analysis and continued scrutiny. Since 1977, the analytical shop in the name of the Governor’s Council of Economic Advisors has remained ‘closed for business’—a fact that amply demonstrates the validity of Prof. Stigler’s conclusion.

The purpose of *The Maryland Journal* is to fill the analytical void that surrounds Maryland’s public policies. To that end, the Journal welcomes analysts who have established records of integrity, competence, and humility.

I am pleased to introduce the inaugural volume of *The Maryland Journal*. Readers will find that the Journal’s coverage is topical. Indeed, since the turn of the New Year, every topic covered in this maiden volume has received a front-page billing in the *New York Times*, *Wall Street Journal*, or *Baltimore Sun*.

Prof. Dr. Steve H. Hanke
Baltimore
January 11, 2011

HOW TO MAKE BALTIMORE A SUPERSTAR CITY

STEPHEN J.K. WALTERS, Ph.D., AND LOUIS MISERENDINO

INTRODUCTION: A TALE OF THREE CITIES

THE GREAT EVACUATION OF BALTIMORE began shortly after World War II and continued for six decades: between 1950 and 2008, its population fell from 950,000 to 637,000. Concurrently, the city population not only shrank, but also became poorer. In 1950, the median family income of Baltimoreans was seven percent *above* the U.S. figure; by the 2000 census, the median household income¹ for city residents was 28 percent *below* the national median.

We all know — or think we know — why this happened. The usual narrative involves the following elements: racial bias that caused whites to flee an increasingly diverse urban population; our ecologically unfortunate preference for suburban lawns and auto travel over dense city neighborhoods and public transit (or walking); and the transition from a manufacturing- to a service-based economy that doomed America's old industrial cities to inevitable decline. In Baltimore, however, we often console ourselves with stories about the heroic political figures who staved off complete disaster of, say, Detroitian proportions, with a downtown redevelopment strategy² that has made the Inner Harbor a tourist attraction and, in recent years, slowed population losses to a mere trickle (though not job losses: from 2002 to 2008, average annual employment in the city fell by over 30,000³).

There is some truth in all this, of course. Racial bias surely influenced some relocation decisions — although the exodus of the black middle class from core cities in the past two decades suggests that flight often has other, more mundane motives.

And density is doubtless a turn-off for some — yet the popularity of gentrifying Baltimore neighborhoods like Federal Hill and Canton makes clear it is an attraction for others.

Overlooked in the standard story line is a remarkable real-world plot twist, however: some cities have coped with flight, suburbanization, and deindustrialization much better than others. Indeed, cities like Boston and San Francisco — each of which shares with Charm City a bayside setting, an industrial past, and a present that is politically progressive — have made such dramatic turnarounds that today they enjoy status as “superstar cities.” Their periods of decline are so far in the past that comparing Baltimore to them is often considered unfair. (San Francisco, after all, enjoys the advantage of nicer weather, and Boston has, well, awful weather, but... there must be something. A superior baseball team?)

In fact, by most measures Baltimore was actually doing better — or, more accurately, less badly — than both Boston and San Francisco in the decades immediately following WWII. From 1950 to 1975, Baltimore lost 10 percent of its residents, but (weather and other conditions notwithstanding) San Francisco’s population fell 14 percent and Boston’s 21 percent. From 1947 to 1972, the number of manufacturing jobs declined by 25 percent in Baltimore, but 28 percent in San Francisco and 42 percent in Boston. Not surprisingly, crime flourished in all three cities as they depopulated and their economies struggled. — Yet as of 1975 the overall crime rate in San Francisco (where Hollywood used to film gritty cop dramas like “Dirty Harry”) was actually 19 percent higher than Baltimore’s, and Boston’s was a staggering 53 percent higher.

Then, miraculously, things got better in the other two bay cities. Between 1980 and 2000, San Francisco’s population increased 14 percent and Boston’s five percent, while another 17 percent of Baltimore’s residents departed. Between 1979 and 2005, while San Francisco’s real median household income surged 35 percent and Boston’s 26 percent, Baltimore’s fell 6 percent. And by 2005 Baltimore’s violent and property crime rate exceeded Boston’s by 20 percent and San Francisco’s by 29 percent.⁴

What happened? How did San Francisco and Boston resist the gravitational pull of race bias, fondness for suburban living, and deindustrialization? And why didn’t Baltimore follow suit? Were its sister cities’ leaders more insightful or progressive with regard to redevelopment strategy?

Not at all. In fact, the political leadership of all three cities was of like mind regarding urban renewal throughout the post-WWII era. They all taxed their citizens aggressively to fund large-scale projects that aimed to clear “blighted” neighborhoods and replace them with public housing and other civic improvements, while funding generous social programs for their increasingly needy populations. In particular, all three taxed real property — the residences, factories, offices, shops, and other physical capital that make up the economic foundation of any city — at high rates. In the mid-1970s, Baltimore’s property tax rate of about 2.3 percent of market

value, though more than double that in its surrounding counties, was actually well below San Francisco's near-three percent rate; Boston's property tax bureaucracy was in such disarray that its statutory rate approached 20 percent (though based on obsolete assessed values that had little correspondence to then-current market prices). As we have seen, none of this was working terribly well. Even if you tax things that cannot move, you will find, in the long run, that they can decay.

Eventually, however, two tax revolutions — resisted strenuously by the political leaders of both San Francisco and Boston — dragged those cities kicking and screaming into a new economic era. In California, where the inflation of the mid-1970s had led to crushing real estate tax burdens, voters overwhelmingly approved Proposition 13 in 1978, capping local property tax rates at one percent of properties' 1975 values and limiting subsequent increases in assessments to two percent annually (until a property was sold). Overnight, San Francisco had to chop its tax rate by almost three-fifths. Elected officials predicted a budgetary disaster of biblical proportions. Yet almost immediately, and in spite of "stagflationary" macroeconomic conditions as bad or worse than those we are now experiencing, the city experienced a downtown building boom that broadened its tax base, staunched job losses, and began the process of repopulation and recapitalization that would make it a superstar.

Massachusetts voters passed Proposition 2 ½ in 1980, forcing Boston to cut its effective property tax rate by an estimated 75 percent within two years. Boston had lost a remarkable 12 percent of its population between 1975 and 1980, but the tax cap instantly made the city more hospitable to investment in physical capital. In San Francisco, that soon attracted employers and residents, and Boston, too, was set on a path of greater prosperity, increasing safety, and enhanced quality of life.

Since most jurisdictions in Maryland enjoy property tax rates less than half of Baltimore City's, there has never been much sentiment for a statewide revolt here (and, in any case, the state constitution forbids referenda on tax issues). However, why haven't Baltimore's citizens demanded that their elected representatives cut their property tax rate to a level competitive with neighboring counties? Why haven't our leaders learned from and emulated the policy experiments conducted (however unwillingly) by their sister cities?

There are two obstacles to such reform. First, the damage wrought by high property tax rates unfolds so slowly, over decades rather than months or years, that it is easy to dismiss this policy variable as unimportant to a city's destiny. Indeed, analysts frequently confuse some of the symptoms of a non-competitive property tax rate, such as disinvestment and the population and job losses that result from it, for the real causes of urban decline. Second, even those who see property tax relief as a major tool of urban revitalization often believe that significant tax cuts are politically impossible. Cutting tax rates by anything more than token amounts, by this reasoning, would force such drastic cuts in city government spending that

no politician would risk them. High rates have painted us into a corner, and there is no way out.

The rest of this article addresses both issues. In the next section we highlight the way high property taxes wreck cities over time; succeeding sections provide evidence of the dynamic effects of rate cuts in cities (like San Francisco) that have undertaken them, and outline a novel plan that can harness these effects in Baltimore without doing violence to the city's short-term budget priorities. We believe that with careful planning and firm commitment, Baltimore City's tax rate can be cut substantially, its tax base broadened, its fiscal position strengthened, and its quality of life improved, while facilitating "smart growth" for the rest of Maryland.

THE IMPORTANCE OF BEING CAPITAL-FRIENDLY

Imagine, for a moment, that you are contemplating building your dream house on either of two lots, one in Baltimore City and the other a few miles away in the county. To keep things simple, assume the lots are very similar: comparably cheap, the same size, and equally pleasing in all respects. Your architect and contractor tell you that your dream can be realized for a mere \$250,000 (you are not an extravagant dreamer). Deciding on your future address might seem like a coin flip, until you talk to your accountant.

The problem is that the city's property tax rate is 2.268 percent of assessed value, while the county's is a mere 1.1 percent (though the state, of course, adds its 0.112 percent rate no matter where you live). Assuming that the tax assessors in either jurisdiction will appraise your new dream house at the same \$250,000 construction cost in either case, this is likely to propel you toward the suburbs. If you put \$50,000 down in this economic climate, your monthly mortgage and tax payment⁵ in the city will be \$1,569.48, against only \$1,326.14 in Baltimore County. Regarding sprawl, the further you go from Baltimore, the cheaper things get: for example, in Bel Air your monthly payment would be \$1,286.14, and in Anne Arundel County \$1,279.48.

Some people may not worry about this \$243.34 monthly surcharge for city life, or may be happy to pay that amount for 'urban amenity' (although in this case the lots are as similar as can be). If, however, people are generally *not* indifferent to money, or if 'urban amenity' includes less-safe streets, poorer schools, or crumbling infrastructure (as even those of us who love Baltimore must admit it does) then our long-running propensity to exit the city is not hard to understand. Those heading out of town in recent decades need not have been racists or ecologically insensitive, but just frugal.

Those who argue that property taxes "don't matter much" frequently cite Baltimore's generally lower property values as an offset to the city's higher tax rate. In a world where property never decays, or where owners do not care about future returns on their investments, this argument might have some merit; in the real world,

it is nonsense. In our example, the monthly payment on our city dream house could be made equal to that in the county if its market (assessed) value⁶ fell from \$250,000 to \$216,901. That is, an asset in the city would have to be worth (or sell for) about 13 percent less than a comparable one in the county, thanks to the difference in tax rates. Clearly, then, the desire to avoid such capital losses will channel new investment out of the city, but even *existing* assets will be affected by the city's non-competitive tax rate. As homeowners know, over time such assets will need new roofs, updated kitchens, and much else to keep them acceptably habitable. But as we have seen, every dollar invested in high-tax city property earns a lower yield than a dollar invested in county property; the result will be a lower net investment rate and higher decay rate of city property. Indeed, even ordinary inflation favors investment outside the city: if our county dream house appreciates ten percent or \$25,000, subjecting us to an additional \$303 in annual property tax, our city house could only appreciate \$12,731, or we would face a higher annual liability. In sum, Baltimore's high tax rate biases investors against building, improving, or even buying real property within the city limits.

The hard truth, then, is that property taxes matter a great deal, but they matter in slow motion. The tax-induced decay rate of the existing stock of housing, and some types of business property, on much of which the city applies a tax rate 2.5 times that on residential property, is scarcely visible from one year to the next. That is a prime reason why, historically, property tax hikes have been politically favored over available alternatives: new revenue flows in immediately, while the ill effects accumulate slowly, and perhaps can be blamed on successors. Over the decades, however, these ill effects become impossible to ignore. Baltimore's 30,000 abandoned properties⁷ and countless more in disrepair are just the most obvious signs of the city's long-running disinvestment crisis. Since every point in Baltimore City is fewer than five miles from the more capital-friendly environment of Baltimore County, the decades since the 1950s have seen much investment in the suburbs and little in the core city.

Remarkably and sadly, a large portion of the investment that has occurred in town shows conclusively that some officials, at least, do understand that the city's high property tax rate is a major barrier to renewal. Starting with Charles Center in 1958, every major downtown project undertaken by redevelopment authorities has involved explicit or implicit subsidies aimed at offsetting the city's greater tax bite and coaxing investors back from the suburbs. Sometimes these subsidies involve a 'buy-high, sell-low' gambit in which property is purchased via eminent domain condemnations and the resulting large tracts are turned over to developers at a sufficiently low price (and appraised value) to make a project's ultimate after-tax cash flow competitive with that in neighboring jurisdictions. Sometimes the subsidies take the form of "payments in lieu of taxes" (PILOTs) or "tax increment financing" (TIFs) or tax credits to eventual purchasers for a given number of years following completion

of a project. It is difficult, however, to find any city development project of any size in the last half-century that has not involved one or more of these methods of mitigating how much the city's exorbitant property tax rate serves to repel new investment.

This leads to a troubling question: If city officials know that tax relief targeted to favored developers can encourage investment and rejuvenate crumbling commercial districts and decaying neighborhoods, why are they not interested in more general tax cuts? That is, if it is a good idea to dole out cuts to high rollers to induce them to make multi-million dollar investments in downtown office towers or waterfront condos, why are cuts for *everybody* not seen as a great idea?

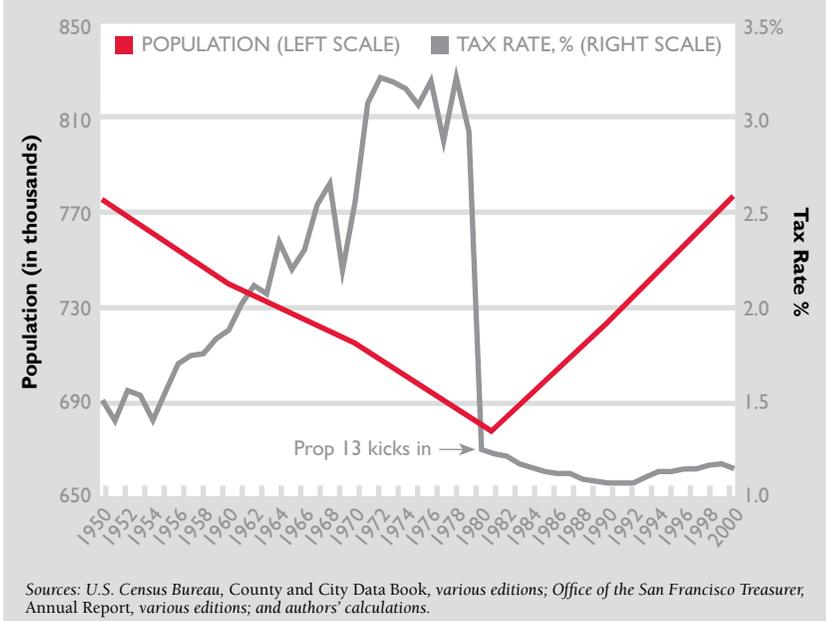
A cynic might say that the current situation serves the powers-that-be quite well. Certainly, the city's high tax rate is a major obstacle to investment, but by selectively rather than generally removing this obstacle, considerable power is focused in City Hall and the urban renewal bureaucracy. Developers who want the PILOTs, TIFs, and other goodies that will make a project profitable have to make friends in high places. At the least, this vests with city officials an enormous amount of power over development decisions; at most, it is an invitation to corruption and a 'pay to play' political culture. In these circumstances, the recent investigations and indictments of Baltimore's mayor and one member of its City Council with allegations of corruption involving payments or gifts from developers potentially seeking exactly the sorts of tax breaks discussed earlier are really not surprising. Indeed, given the millions at stake in these projects, the only surprise might be the paltry amounts of the alleged unethical payments involved in the cases uncovered so far.

But let us not be cynical: let us assume that city officials are not using the current inequitable redevelopment strategy to acquire more power or wealth, but simply fail to appreciate the strong dynamic effects of broad-based tax cuts. Or that, as discussed earlier, they are convinced that the city simply cannot afford to cut taxes, for to do so would require such budget cuts (at least in the short run) that would harm the city (or, at least, their near-term political prospects). To address such concerns, we need only take a more detailed look at a case example of the effects of significant across-the-board tax cuts in San Francisco.

HOW TO QUICKLY BROADEN YOUR TAX BASE

Tax receipts are, of course, equal to the tax rate times the tax base. The most common blunder made by budget analysts and policymakers is to assume that the latter is fixed. Such thinking often leads officials to assert that, for example, every penny cut from a city's property tax rate costs x million in tax revenue. Those millions of lost revenue quickly add up, so it is not hard to imagine rate cuts of any appreciable size leading to layoffs of police officers, firefighters, teachers, and so forth. In economics jargon, this is 'static' rather than 'dynamic' analysis. In the real world, the tax base is not fixed; indeed, it can change a great deal, and surprisingly quickly, in response to changes in tax rates.

FIGURE I THE REPOPULATION OF SAN FRANCISCO

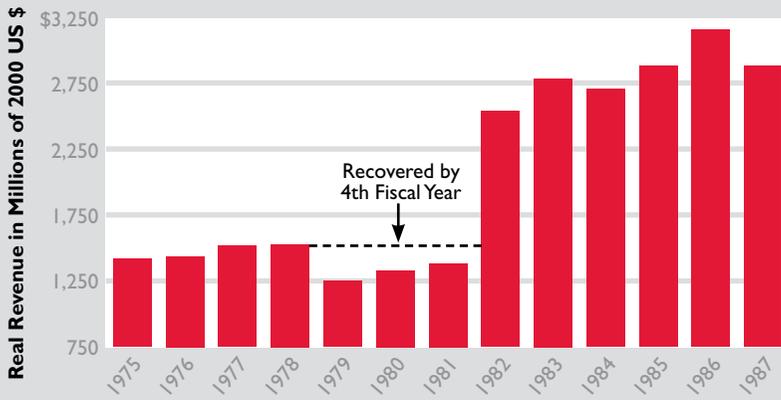


San Francisco provides an excellent example (though neighboring Oakland, distant Boston, and some other cities that have been forced to cut their tax rates by non-trivial amounts show similar dynamic effects). Figure 1 shows the city's steadily climbing property tax rate in the post-WWII era (right scale) and the accompanying downward trend in population (left scale). Up until the late 1970s, this record was, as we have mentioned, even worse than Baltimore's.

Then, in 1978, Proposition 13 kicked in. San Francisco's political elite had warned of catastrophe if California voters were foolish enough to accept tax cuts: a soaring crime rate, shuttered firehouses and libraries, and students with no textbooks. Given their elected leaders' promises of drastic cuts in local government services, one might have expected the city's population to plunge farther and faster. Instead, flight from San Francisco stopped immediately and, in fact, reversed. Apparently, the low post-Proposition 13 tax rates — and the sure knowledge that they would remain low, since the referendum passed with such a large majority and was of such strong appeal that elected officials understood repealing it would be political suicide — was magnetically attractive to new residents and employers.

As a result, San Francisco's tax base expanded enormously and in a variety of ways. First, the city's new or returning residents and employers scarfed up existing properties; they particularly looked in areas that had been emptying out and decaying most rapidly, where the greatest bargains were to be found (i.e., where the previous high taxes and low investment rates had driven values down the most).

FIGURE 2 THE DYNAMIC EFFECTS OF THE PROPERTY TAX RATE CUT IN SAN FRANCISCO



Source: Office of the San Francisco Treasurer, Annual Report, various editions; and authors' calculations.

Thus, almost immediately a surge in real estate transfer taxes started to offset the Proposition 13-related decline in property tax receipts; more slowly, as renovation proceeded, assessed values started to rise and those receipts began to recover as well. In addition, despite adverse macroeconomic conditions⁸ new (unsubsidized) office towers started to sprout downtown, further contributing to the eventual recovery of property tax receipts. And since the city levied a payroll tax, the new jobs associated with these facilities, coupled with enhanced permit, license, and user fees collected from a rising population and strengthening local economy all contributed to the expansion of San Francisco's tax base.

As Figure 2 shows, in the aftermath of Proposition 13, which slashed the city's property tax rate from \$2.925 to \$1.265 per \$100 of assessed value, rolled back assessments to 1975 levels, and limited assessment increases to two percent annually, San Francisco's total tax revenue (in real, inflation-adjusted terms) dipped for only three fiscal years. By fiscal 1982, just four years after city officials had predicted Prop 13 would wreck the city, they were actually collecting 66 percent more inflation-adjusted dollars than they had the year before the proposition was enacted. True, the state government helped municipalities cope with the shock of the tax revolution in the first two post-Proposition 13 budget years; San Francisco received a revenue-sharing check of a little under \$100 million to close a budget gap in fiscal 1979, but in 1980 the state's aid was under \$1 million. The key was that the investment boom and repopulation kicked off by Proposition 13 produced a fiscal dividend that rapidly replaced the "lost" property tax receipts: between 1978 and 1982, sales and use taxes grew 39 percent, utility taxes 64 percent, parking taxes 139 percent, construction permit fees 167 percent, payroll taxes 177 percent, hotel taxes 204 percent, and business license taxes 446 percent. By fiscal 1986, the

assessed value of real property in the city had grown so much that, even with a tax rate about 60 percent below its pre-revolution level, inflation-adjusted receipts from this source exceeded their 1975 level. In 1982, a correspondent from *The Economist* magazine reported that “San Francisco is embarrassed only by its riches. Its \$160 million surplus [\$360 million in today’s dollars] is so large that a member of the Board of Supervisors has gone to court to try to make the city give some back to its taxpayers.”⁹ Given such resources, of course, municipal services could actually be improved, reinforcing the attractiveness of the city for enduring growth.

There is no reason Baltimore cannot enjoy similar success. Indeed, Baltimore might enjoy a fiscal dividend from property tax relief *exceeding* that experienced in San Francisco. The latter collected a payroll tax that was tied to city employment; those who worked in town and chose to reside there after Proposition 13 delivered no new payroll tax revenues to city coffers. Baltimore and all Maryland counties, on the other hand, collect a ‘piggy-back’ income tax that is tied to residential rather than employment location. In contrast to San Francisco, then, each new resident the city attracts might immediately deliver incremental income tax revenue — from both employment and *investment income* — no matter where they work. And since Baltimore has been depopulating so much longer, with so many thousands of properties vacant (i.e., currently viewed as worthless by investors) or in disrepair, the potential increases in its real property tax base might be proportionately greater than in San Francisco and other cities that benefitted from the tax revolts of the late 1970s.

There is an obvious catch. Even San Francisco’s strong ‘dynamic’ response did not produce real revenue increases until the fourth budget cycle after the externally-imposed tax rate cuts. In politics, four years is an eternity, and four years of budget austerity, especially in a politically progressive culture, looks like a route to early retirement. Which mayor or council member wants to tell the public employees’ unions that there will be wage and hiring freezes or layoffs for a few years, but after that money will roll in and all will be well? Which interest groups want to hear that their pet programs will be cut in the near term, but funded even more generously down the road? Little wonder, then, that the elected officials of San Francisco, Oakland, Boston, and other municipalities fought hard against the very cuts that eventually revived their cities.

How can this Gordian knot be cut? How can local leaders’ focus be changed from short-run political costs to the long-run economic benefits of capital-friendliness? By building a bridge *before* you have to cross the financial river: calling forth a fiscal dividend with a credible program for a *future* tax cut that broadens the city’s tax base and makes the lower rate “affordable” and, thus, politically feasible.

A “CASH ON DELIVERY” PLAN FOR BALTIMORE

In San Francisco, and later in Boston, city officials had to cope with a sizeable tax cut that they neither wanted nor expected. The fact the cuts were a result of state-

wide referenda gave them some political cover in dealing with the immediate budgetary fallout, but what really rescued them was the fact that the dynamic effects of these cuts arrived reasonably quickly and with strength, so they could restore and eventually increase spending and staffing levels for favored constituencies within a few budget cycles.

We propose to harness these dynamic effects *in advance* of property tax rate cuts to create a fund that can be drawn upon to offset eventual reductions in property tax receipts that will occur once rates go down. We call this approach “Cash on Delivery”; here is how it might work in Baltimore:

- Since Baltimore is on a three-year assessment cycle, with one-third of city properties re-assessed each year, it should amend its governing charter to deliver a substantial property tax rate cut to take effect *in three years*, after one full re-assessment cycle.
- To make investment in the city more attractive than in the surrounding county, this rate ought to be set below the county’s 1.1 percent rate — to an even *one percent*.
- To make this promised cut binding and politically inviolable, the necessary charter amendment should include a stipulation that *repeal or modification* requires a super-majority popular vote.
- At the lower tax rate, all city property would eventually be more valuable, so savvy investors, developers, and homebuyers would begin to snap up existing properties immediately, delivering increased transfer and recordation taxes to city coffers. As values rose, renovations proceeded, and new developments were installed over the re-assessment cycle, near-term property tax receipts would actually rise. And as the city repopulated, additional piggy-back income tax receipts would also begin to arrive.
- All tax receipt increases exceeding the rate of inflation during the period leading up to the rate cut would be put aside (perhaps in Al Gore’s fondly-remembered “lock box”) as a reserve from which the city could draw to cope with any revenue shortfalls once the cut takes effect. By setting aside the fiscal dividend that would begin to arrive in anticipation of the city’s more favorable investment climate, budget officials would have “cash on delivery” of the cut itself.
- In combination with other measures, e.g., assets sales, including auctions of currently-worthless abandoned property, revenue enhancements from the elimination of unnecessary development subsidies, or debt financing similar to current “revenue anticipation bonds,” this fund would leave the city well-positioned to adapt to the eventual change in its tax structure.

Undeniably, this strategy could falter, and in any plan, the devil is often in the details. Most obviously, the city must keep spending growth under control during

the three-year run-up to the promised rate cut. If it expands entitlements and proliferates programs as its tax base expands instead of locking new revenues in a box, then the arrival of the 'one percent solution' to the city's disinvestment problem would, indeed, involve some near-term political and budgetary trauma like that experienced in San Francisco and Boston in the first couple of years after their tax revolutions. The speed with which local government spending surged during the heady days of the nation's housing bubble, when frenzied buying spiked transfer taxes and prices that we now know were unrealistic and unsustainable inflated property tax receipts, demonstrates that fiscal discipline does not come easily to the governing classes, in Baltimore or anywhere else.

There is no doubt that a substantial property tax rate cut will deliver a fiscal dividend: the rapidly-expanding tax bases of post-tax cut San Francisco and Boston are not accidents, but object lessons. Reasonable people might differ about how big the dividend would be in Baltimore or how soon it might arrive, but we need to stop assuming that we cannot afford tax cuts and start telling our elected leaders that we cannot afford to delay them any longer. The strategy outlined here is a road map forward. If our leaders plan thoroughly, behave responsibly, and take this route to a more capital-friendly Baltimore, they need not slash budgets and suffer near-term political harm. Indeed, those who take up this challenge are very likely to be judged heroes of a genuine urban renaissance.

CONCLUDING REMARKS: WHAT WILL HAPPEN?

This paper has (a) highlighted the transformative effects of significant property tax rate cuts in cities where they have been undertaken, (b) illustrated how excessively high rates repel capital investment that is crucial to a city's economy and quality of life, (c) provided evidence of reasonably rapid and extremely strong dynamic, tax base-broadening responses to rate cuts, and (d) sketched what we believe is a creative strategy by which property tax cuts can be delivered without requiring massive short-run cuts in municipal spending and, thus, without inviting the implacable resistance of interest groups that benefit from such spending.

This does not mean, however, that we believe cutting Baltimore's property tax rate to a level that will make it more attractive to investors, employers, and residents than surrounding counties will be easy, politically speaking. Static rather than dynamic thinking about tax rates is deeply ingrained.¹⁰ The status quo, which clearly vests power over development decisions in City Hall, is enormously appealing to some key constituencies. And while a brighter future is appealing as well, it also seems far off and uncertain, and the steps to get there seem risky.

To overcome the inertia that has kept Baltimore from taking its rightful place as a superstar city, our political leaders need to be reminded that *all* of the city's large-scale redevelopment success stories of recent decades have involved exactly the sort of tax relief outlined here; in essence, these projects are all just isolated

examples of the kinds of dynamic effects that could be happening all over town if we will let them.

These effects then need to be linked in the public consciousness to other outcomes. Opinion-makers should be reminded that with broad-based tax reform, Baltimore's redevelopment will no longer revolve around the choices of its political elite and their well-connected patrons, but instead it will be more democratic, diffuse, and widely shared. Activists should be convinced that when Baltimore starts to attract rather than repel capital investment, employment and wages will grow and the city will lift larger numbers of its residents out of poverty — and, as it does, streets will become safer and schools better.

Environmentalists should know that “smart growth” policy starts with a favorable urban investment environment, for recapitalizing and repopulating Baltimore City is a necessary condition to slowing sprawl and making the region greener. And every Baltimorean needs to understand that tax cuts will not just make the city a cheaper place to live, but more enjoyable. Indeed, with more capital and more people, the city will be truer to its heritage as a patchwork quilt of neighborhoods with a greater array of cultural, dining, entertainment, and social options.

Baltimore is a well-loved city. People care deeply about its condition and want it to improve and provide ever-greater opportunities and quality of life for its residents. In consequence, property tax cuts, which are a crucial element in attempts to revive the city's economy, should ultimately have broad and strong appeal. We have offered this analysis as a way to start a dialogue about the need for tax relief and map a strategy to get it. We hope you will spread the word.

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How to Make Baltimore a Superstar City

- 1 The Census Bureau has shifted from reporting "family" to "household" income, making inter-temporal comparisons problematic. See U.S. Census Bureau, *County and City Data Book*, various editions, available at: <http://www.census.gov/statab/www/ccdb.html>, with older editions available at: <http://www2.lib.virginia.edu/ccdb>.
- 2 For a history and critique of the city's approach, see Stephen J.K. Walters and Louis Miserendino, "Baltimore's Flawed Renaissance: The Failure of Plan-Control-Subsidize Redevelopment," Institute for Justice (June 2008), available at: http://castlecoalition.org/index.php?option=com_content&task=view&id=707.
- 3 See Maryland Department of Labor, Licensing, and Regulation, *Career and Workforce Information*, available at: [http://www.dllr.state.md.us/lmi/emp/emp/emp/emp/tab#bcit.shtml](http://www.dllr.state.md.us/lmi/emp/emp/emp/tab#bcit.shtml).
- 4 See U.S. Census Bureau, *County and City Data Book*, various editions, available at: <http://www2.lib.virginia.edu/ccdb>.
- 5 Assume a 30-year mortgage at a fixed interest rate of five percent, and leave homeowners' insurance aside.
- 6 This calculation leaves the assumed down payment and interest rate unchanged.
- 7 See Housing Authority of Baltimore City, available at: http://www.baltimorehousing.org/wgo_detail.asp?id=323.
- 8 Nationwide, the unemployment rate averaged eight percent over 1979-1983, the inflation rate averaged 12.9 percent in 1979-80, and housing starts fell 47 percent from 1978-82, while the average mortgage interest rate was 10.8 percent in 1979 and 15.1 percent by 1982. In short, San Francisco moved forward against a very strong economic headwind.
- 9 See *The Economist*, "California; not-so-golden state," November 20, 1982, U.S. edition, p. 41.
- 10 For example, the Mayor's Blue Ribbon Committee on Taxes and Fees recommended in its report dated Dec. 5, 2007 that Baltimore's property tax rate be cut to a level 1.5 times that of the average of nearby counties, but also recommended raising other taxes and fees to replace the lost revenues.